

MOODY'S

RATINGS

Rating Action: Moody's Ratings upgrades Landsvirkjun's ratings to A3; outlook stable

25 Sep 2024

Frankfurt am Main, September 25, 2024 -- Moody's Ratings (Moody's) has today upgraded the long-term issuer and senior unsecured ratings of Landsvirkjun to A3 from Baa1 and the backed senior unsecured rating to A2 from A3. Concurrently, Landsvirkjun's Baseline Credit Assessment (BCA) has been affirmed at baa3. The outlook has been changed to stable from positive.

RATINGS RATIONALE

Today's rating action follows the upgrade of the sovereign long-term issuer rating of the Government of Iceland to A1 from A2 and outlook change to stable from positive on 20 September 2024. For details on the rationale for the sovereign rating action, please refer to the press release <https://ratings.moodys.com/ratings-news/428884>.

Landsvirkjun's unguaranteed A3 ratings now incorporate a three-notch uplift from the baa3 BCA for potential extraordinary support from its owner the Government of Iceland under our Government-Related Issuers methodology. This factors in the Icelandic government's stronger credit profile as evidenced by the rating upgrade to A1. It is based on our assessment of very high default dependence between Landsvirkjun and the Government of Iceland, and a high likelihood of the company receiving support from the government in the event of financial distress. Our expectation of high support reflects (1) Landsvirkjun's strategic importance to Iceland, given the company's position as the country's dominant power producer and the role it plays in providing electricity to the power-intensive industry, which directly contributes to around a third of Iceland's exports; and (2) the high level of commitment that the government has shown in the past through the provision of guarantees of collection to support the company's debt.

The affirmation of the baa3 BCA reflects Landsvirkjun's dominant position in Icelandic power generation and the benefit from long-term take-or-pay contracts, with around one third of available capacity linked to the aluminium industry. Although Landsvirkjun has reduced its exposure to aluminium price volatility and made progress in diversifying its customer base, the BCA remains constrained by (1) the concentrated

exposure to a small number of counterparties in the aluminium industry; (2) the reduced but still existing exposure to aluminium price movements; and (3) our expectation of a significant increase in capital expenditure over the period 2024-2028 as the company plans to develop and build four new projects (hydro, geothermal and wind power plants).

On 12 September 2024, Landsvirkjun received a permit from the National Energy Authority (NEA) for the hydro power project Hvammsvirkjun with a capacity of up to 95 megawatts (MW). Landsvirkjun expects the start of operations in 2028. Concurrently, the NEA granted permit for the 65 MW expansion of the Sigalda Power Plant. Together with Landsvirkjun's first large-scale wind farm, the 120 MW Búrfellslundur project, expected to be built over the period 2024-26 and for which an approval was received on 11 September 2024, three out of Landsvirkjun's four main investment projects will enter the construction phase by 2025.

Landsvirkjun is entering this investment cycle with a strong financial profile, as it has reduced its reported total debt to US\$773 million as of June 2024, more than 50% lower compared to the 2021 level. Accordingly, the company's ratio of funds from operations (FFO) to net debt (as adjusted by Moody's) reached 34.7% in the twelve month that ended June 2024, slightly above our upgrade guidance for the BCA. The affirmation of the BCA nonetheless reflects our expectation that credit metrics may weaken somewhat as the company executes its capital expenditure programme. According to Landsvirkjun's dividend policy, future capital spending is taken into account for the determination of dividends. We therefore expect that the increased capital spending over the period 2024-28 will likely lead to reduced dividend payouts during the construction period when free cashflow turns negative.

RATIONALE FOR THE GUARANTEED DEBT RATING

The upgrade to A2 from A3 of the backed senior unsecured rating on the notes that are supported by a guarantee of collection from the Government of Iceland and the City of Reykjavik reflects the value of that guarantee. Guarantees of collection usually do not offer bondholders the same contractual protection as a timely payment guarantee. There is a risk that the government would not step in with timely repayment should the company fail to meet its obligations, as exhaustive administrative and legal procedures must be followed before the guarantors are obliged to pay. The A2 rating therefore reflects a very high likelihood that the government would pay on a timely basis, but the positioning of the guaranteed debt rating one notch below that of the Government of Iceland reflects the residual uncertainty of timely payment from a single-A rated sovereign.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects our expectation that the company will continue to maintain FFO/net debt of at least 25% on a sustained basis.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

The BCA could be upgraded if Landsvirkjun's FFO/net debt remains consistently above the low-30s in percentage terms; along with a further diversification of its customer base and progress in the execution of its sizeable investment programme. An upgrade of the BCA may not necessarily lead to an upgrade of Landsvirkjun's unguaranteed ratings. The guaranteed rating could be upgraded if the Icelandic government's rating was upgraded.

The BCA and unguaranteed ratings could be downgraded if Landsvirkjun's FFO/net debt appeared likely to decline below 25% on a sustained basis. In addition, the unguaranteed ratings could be downgraded if our assessment of high support for the company was to be revised downward. The guaranteed rating could be downgraded if the Icelandic government's rating was downgraded.

The methodologies used in these ratings were Unregulated Utilities and Unregulated Power Companies published in December 2023 and available at <https://ratings.moodys.com/rmc-documents/412151>, and Government-Related Issuers methodology published in January 2024 and available at <https://ratings.moodys.com/rmc-documents/406502>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of these methodologies.

CORPORATE PROFILE

Landsvirkjun is the dominant power producer in Iceland, responsible for over 70% of the country's total electricity generation capacity. The company provides 100% renewable energy to public utilities and power intensive industries, particularly under long-term take-or-pay contracts with aluminium smelters. Landsvirkjun is a partnership company wholly owned by the Government of Iceland.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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